MORNING NEWSLETTER

March 2017

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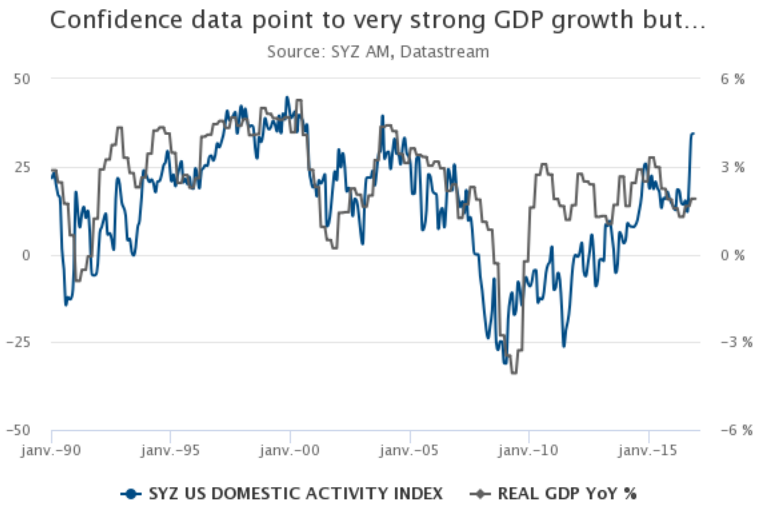
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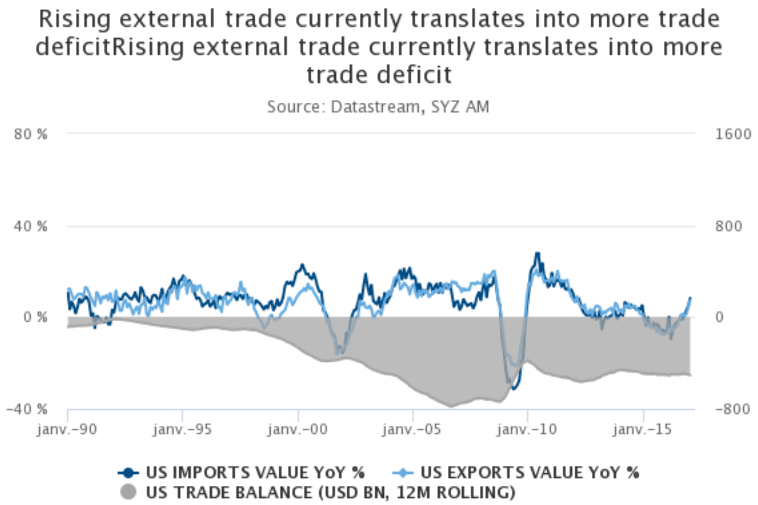
Improvement in US confidence not reflected in reality yet

Most US surveys have continued to improve in February and point to a pronounced acceleration of US GDP growth in the first quarter. Our own SYZ US Domestic Activity Index, based on consumer and small business confidence, has reached a level consistent with GDP growth around 4%...

However, this rosy picture has to be balanced by the lack of significant improvement in so-called "hard data", i.e. data of concrete household spending, business investment, industrial production... Indeed, the current estimate of Q1 GDP growth stands at 1.2% according to the Atlanta Fed model, a subdued pace of growth, quite disconnected from the ongoing "hype" about US growth prospects.

Such disconnect is unlikely to last for very long. It might well be that "hard data" finally converge toward sentiment indicators, spured by the enactment of promised tax cut. But a potential lag or a disapointment in tax reforms might also, on the contrary, deflate the optimism-led confidence increase of the past few months...





02

Fiscal reform needed to reverse the US trade deficit/growth relationship

The US trade deficit has been at the heart of the last presidential campaign, with Mr Trump vowing to bring it back at a balanced level by imposing tariffs on imports. Ironically, since the election of Mr Trump, the US trade deficit has kept … widening!

Indeed, after hitting a 5-year low in March last year, US imports have rebounded steadily along with economic activity. They have even rebounded more rapidly than US exports, resulting in a trade deficit widening (with January marking the widest monthly deficit since 2012).

This highlights the current relationship between US economic growth and the trade deficit: an improvement of the former leads to a deterioration of the latter. Donald Trump has been elected on an agenda to change that relationship, but that implies managing to implement the much discussed Border Adjustment Tax. Again, the ability of the new administration to deliver on its ambitious fiscal agenda is a key question for the coming months.

03

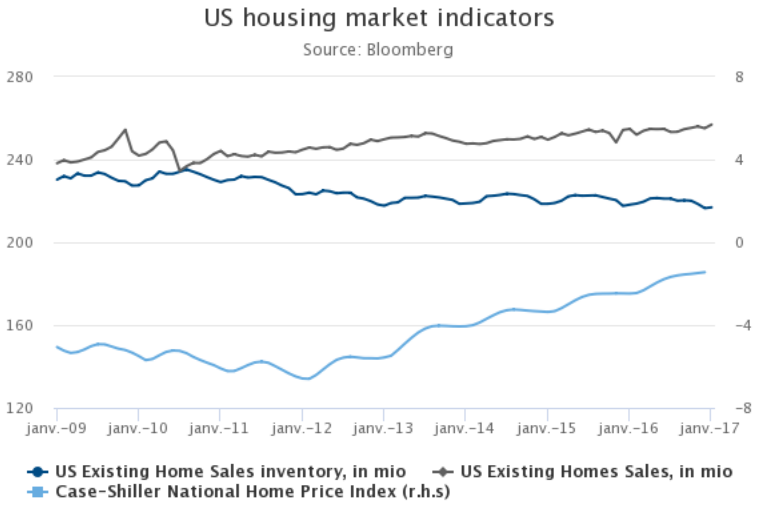
Housing market - US home sales surged to a 10-year high

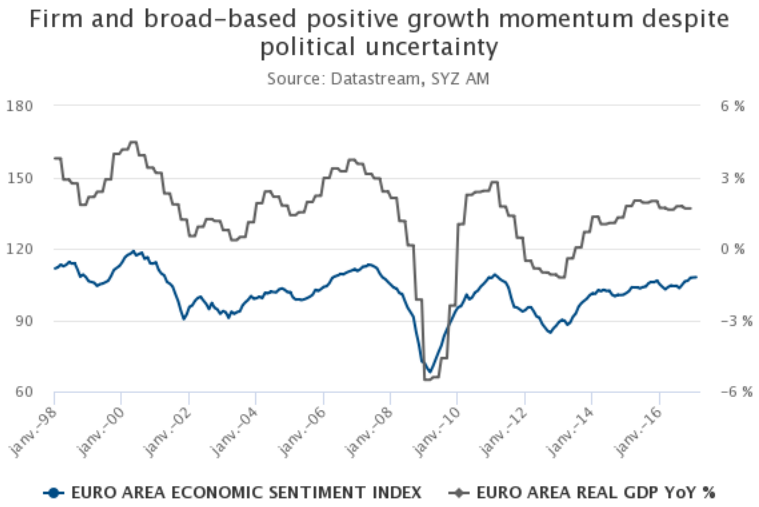
In January, existing home sales climbed to the highest level since 2007, beating market expectations.

Although mortgage rates and housing prices are both higher, housing demand remains resilient denoting a growing confidence in the economy. The solid demand could also be explained by homebuyers' preference to be locked with low interest rates in an environment where expectations of a more than 25bps rate hike are rising.

According to the latest report, homes resale increased by 3.3% compared to previous month and gained 3.8% yoy. Coupled with the still very low level of existing properties available for sale, this contributes to push home prices higher as illustrated by the Case-Shiller Index (+5.8% yoy).

The US housing market is expected to keep its positive momentum in 2017 but it might face downside risks such as if the shortage on home inventories expands. Properties available for sale need to increase to reach a healthy balance between supply and demand.





04

Europe would be great (economically) without political uncertainties

Imagine a world without election-linked political uncertainty. In such a world, the Euro area would currently be one of the bright spots of the global economy. Because its current growth cycle has started later than in the rest of the developed world, Europe is still enjoying the support of declining unemployment, pent-up demand in business investment spending and monetary policy still in full accommodative mode.

The comparison with the US is striking. While, in the US, economic surveys have been driven higher BY expectations of political change, in Europe, they have steadily risen DESPITE a very uncertain political outlook. All of them point to GDP growth being above 2% in annualized term in the first quarter.

The main economies of the Euro area are all growing above potential currently and it seems that only a negative confidence shock resulting from an unwelcomed election outcome could derail the ongoing trend.

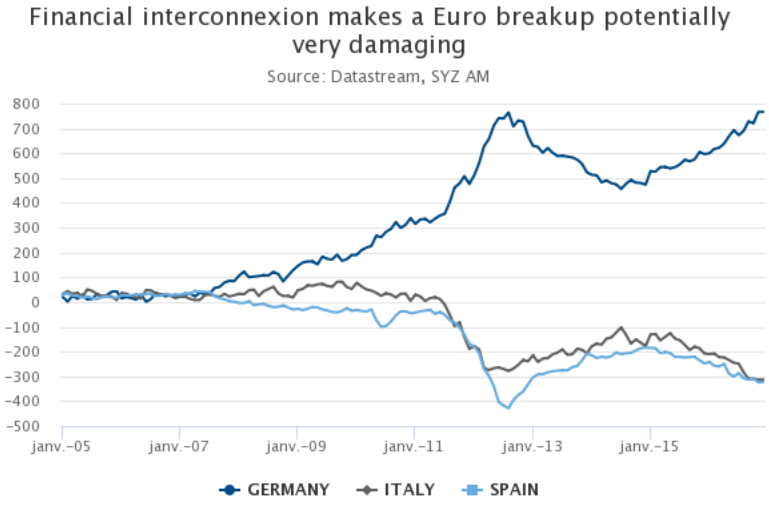
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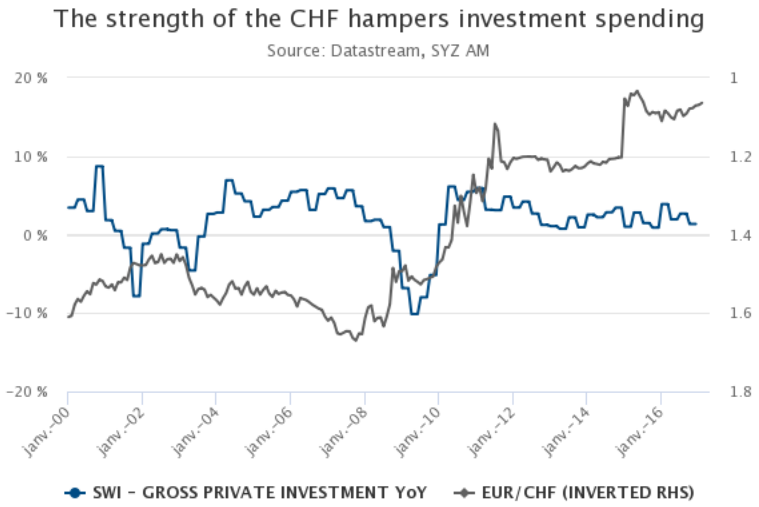
A Euro breakup would be bad for all Eurozone countries

Upcoming elections in Netherlands, France and Germany fuel uncertainty about the short term outlook of the Euro area, given the strength of anti-European parties in polls and the experience of 2016 and its unexpected anti-establishement votes in the UK and the US.

With that in mind, close scrutiny is paid to metrics that had signaled rising euro breakdown risk during the government debt crisis in 2011/12. Among them is the widening of Target2 imbalances, basically the claims or liabilities that each country holds toward the other countries of the Eurosystem. Germany's claims on other Euro area members have climbed back toward their peak of 2012 while Spanish and Italian liabilities have increased.

Even if part of the recent movement is probably linked to the ongoing ECB QE program and doesn't necessarily reflect actual safe-haven capital flows within the Euro area, it remains a telling illustration of the potential risk linked to a major country exiting the euro area. If this were to happen, the financial linkages between Euro area economies are now so large that it would necessarily have a strong impact even on the countries remaining in the Eurosystem. While such a scenario remains a low-probability event, its potential consequences cannot be lightly downplayed.





06

Weak Swiss GDP growth caused by CHF strength

The Swiss franc remains a Damocles sword hanging above its economy's outlook. This is the key takeaway of the release of Q4 GDP data. Indeed, the Swiss economy posted weak economic activity in Q4 last year (+0.1%). And the culprit for such weakness appears to be the CHF strength.

The CHF is on an appreciating trend against the euro since 2008, supported by reduced recycling of current account surplus and safe-haven flows driven by fears of euro disintegration. The SNB has tried to counter the trend by heavy interventions, but when the Brexit referendum brought back political risk premium in Europe, the CHF resumed its appreciating trend in the second half of 2016.

In the 4th quarter, business investment and exports both contracted and almost offset strong consumption growth. The typical reaction to be expected with CHF strength, which supports consumption by lowering the price of imported goods but has clearly weighted on investment growth in the recent years.

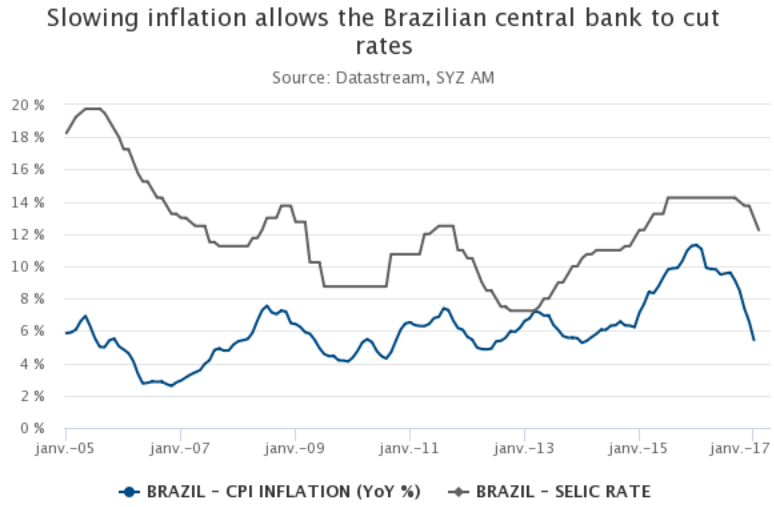
07

The Brazilian central bank can finally relay its stance

Almost a year after the beginning of Dilma Rousseff's impeachment that coincided with the trough of the economic crisis, the Brazilian economy is yet to recover from its worst recession in 30 years. Its GDP declined by -0.9% in Q4, down 8% in two years.

However, the trend has now become more encouraging and supports the prospect of growth resuming in 2017. Political change has helped to reverse the currency slide and has provided a structured fiscal framework designed to control public spending. As a consequence, inflation has slowed down sharply after peaking above 10%.

It allows the central bank to loosen its monetary policy, after having been forced to be restrictive to stem inflation and the currency slide. The BCB cut the Selic rate by 75bp in February, extending the rate cut cycle initiated in October last year. This loosening in financing conditions, expected to continue in 2017, will support the ongoing gradual recovery in economic activity.





08

China - Trade balance from a surplus to a deficit

One of the main objectives of the Chinese officials is to rebalance an economy based on investment and exports towards more domestic demand.

In February, the latest numbers published regarding exports and imports surprised the consensus as they were released respectively at -1.3% YoY (consensus: 14%) and 38.1% YoY (consensus: 20%).

The strong import growth (reaching a five year high) surprised the market and was a combination of several factors: higher commodity prices (especially iron ore up 27% YTD), strong investments and base effect. On the other hand, exports to Europe and to the US weighted as they contracted -5.6% YoY and -4.0% YoY. Hence, for the first time since three years, the trade balance went from a surplus to a deficit (USD -9.2 bln) in February.

Finally, rising imports coupled with some strong PMIs (manufacturing) in this beginning of the year are suggesting that activity is for the time being picking up in China.

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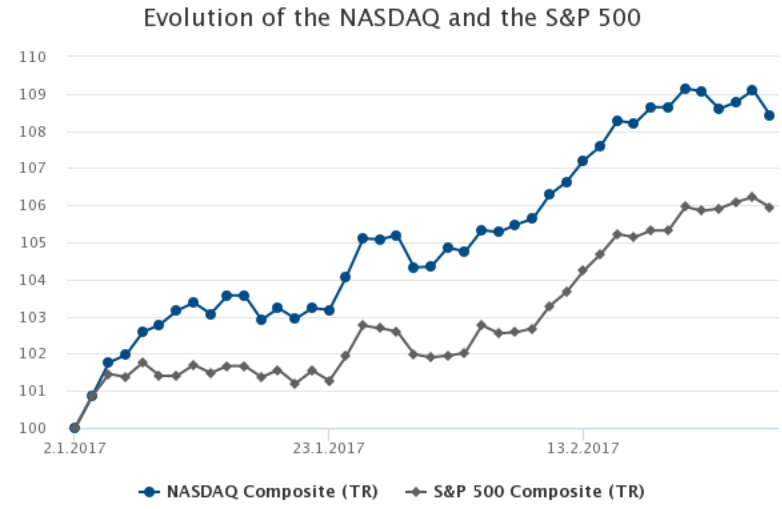
Equities – Outperformance of the NASDAQ in the US

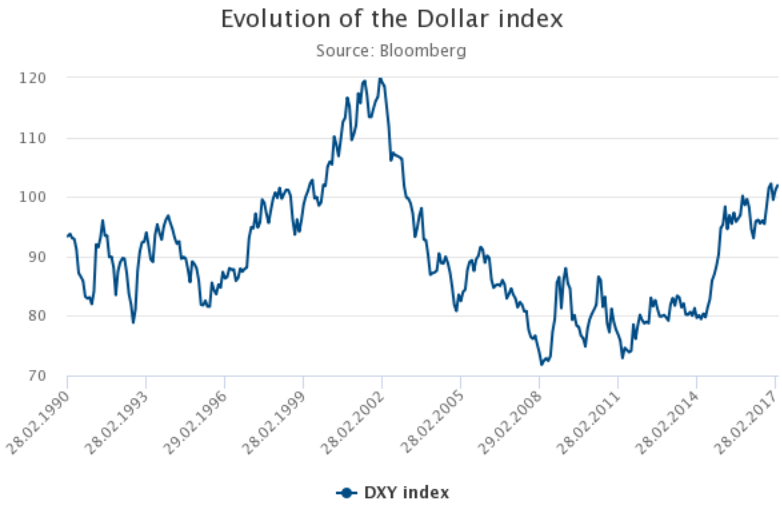
The NASDAQ index (information technology) has performed spectacularly well in recent years, and on a year to date basis outperformed the S&P 500 by +2.5 % (8.4% vs 5.9%).

It is also impressive to look at a constituent level with blue chips posting spectacular returns: Apple +18.3%, Yahoo +18.1%, Facebook +17.8%, Tesla +17.0%, and Ebay +14.2%.

In terms of valuations, there is nothing that would justify such euphoria. The trailing Price Earnings ratio is close to 41, almost twice the Price Earnings ratio of the S&P 500. Moreover, analysts expect the earnings of this index to more than double in the coming year.

Obviously, such valuation levels can become much more stretched than this, especially when it comes to the NASDAQ, and there is clearly policy support for US equity markets at courtesy of Donald Trump. Yet it is undoubtedly concerning to see such high level of optimism in the market place.





10

FX - Is a stronger dollar really welcomed?

Investors are betting about a stronger dollar heading into 2017. The main arguments are the coming rate hike in the US combined with the plan of Trump on taxes and infrastructure. Although it seems clear that the tax plan could lift the dollar, is it really desirable for the US and for the world?

The key question is to know whether a strong dollar will be good for the US economy. Similar to Reagan in the 80's, the domestic agenda of Trump could also lead to a strong dollar but the world is now different. This is particularly true when looking at the US denominated debt held by foreign countries, especially emerging countries, that could see the cost of debt soaring should the dollar appreciate. Ultimately, the value of the dollar is at the center of a fragile equilibrium and any significant change in its value has repercussions.

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